

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2016

Docket No. ACR2016

RESPONSES OF THE UNITED STATES POSTAL SERVICE TO  
QUESTIONS 7-9 OF CHAIRMAN'S INFORMATION REQUEST NO. 4

The United States Postal Service hereby provides its responses to the above-listed questions of Chairman's Information Request No. 4, issued on January 11, 2017. Each question is stated verbatim and followed by the response. All other responses were filed yesterday, January 18.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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7. The Postal Service justifies the following [First-Class Mail] discounts pursuant to section 3622(e)(2)(B):

- 5-Digit Automation Flats

See FY 2016 ACR at 20-21.

For each discount, please provide a plan to align the discount with its avoided costs. Each plan should include a schedule indicating when the full reduction will occur.

**RESPONSE:**

Contingent on price cap availability, operational efficiencies, and changes in cost avoidance, the plan for reducing the 5-Digit Automation Flats passthrough to 100 percent is to decrease it by at least 5 percentage points (e.g., from 155 percent to 150 percent) in each subsequent annual market dominant price adjustment. For instance, when the Docket No. R2017-1 discount takes effect on January 22, 2017, the passthrough will be set at 154.6 percent. The Postal Service is committing to decreasing the passthrough to 149.6 percent or less in the next annual market dominant price adjustment. The Postal Service is committing to a 5 percentage point minimum annual reduction, rather than the 10 percentage point reduction used for Standard Mail passthroughs, because of two concerns. First, the Postal Service does not wish to give significantly larger than average increases to the finest presorted flats in the First-Class Mail stream. Second, the Postal Service does not see a substantial opportunity to lower the benchmark price for 3-Digit Automation Flats.

The Postal Service cannot predict with certainty when the full reduction of the passthrough will occur because a number of factors influence when the passthrough

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may reach 100 percent. For instance, the cost avoidance has largely fluctuated from year to year since the advent of the PAEA, as demonstrated in the table below. The FY 2016 cost avoidance is the lowest cost avoidance in the last 10 years

**FCM 5-Digit Auto Flats (benchmark: 3-Digit Flats)**

Year	Discount	Cost Avoidance	Passthrough
ACR 2007	10.1	11.9	85.0%
ACR 2008	11.5	16.2	70.9%
ACR 2009	16.2	16.9	96.1%
ACR 2010	16.2	17.4	93.1%
ACR 2011	17.4	18.8	92.6%
ACR 2012	18.8	14.3	131.5%
ACR 2013	18.8	14.1	133.3%
ACR 2014	18.3	15.2	120.4%
ACR 2015	19.2	15.9	120.8%
ACR 2016	19.2	11.9	161.3%
R2017-1	18.4	11.9	154.6%

With no intent of undermining its foregoing position, for illustrative purposes only, the Postal Service provides the following unlikely illustration. Using the January 22, 2017 passthrough of 154.6 percent as the starting point and holding all factors constant from fiscal year to fiscal year (e.g., the cost avoidance and the price difference between 3-Digit Automation Flats and 5-Digit Automation Flats, in other words the discount) while also assuming that the Postal Service lowers the passthrough by no more than 5 percentage points in the first ten price changes, it would take 11 price changes to lower the passthrough to 100 percent. However, the Postal Service reiterates its position that it is impossible to predict with any degree of certainty when the discount will align with the cost avoidance.

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8. For the following [Standard Mail] discounts, the Postal Service asserts that adjusting the benchmark price to reduce excessive passthroughs would "send an inefficient price signal to mailers:"
- Automation AADC Letters
  - Nonautomation 5-Digit Nonmachinable Letters
  - DNDC Carrier Route Letters
  - DSCF Carrier Route Letters
  - DNDC High Density and Saturation Letters
  - DSCF High Density and Saturation Letters.

See FY 2016 ACR at 39-41; 46-49.

- a. For each discount, please provide the percentage change in the benchmark price necessary to reduce each excessive discount to 100 percent of its avoided cost.
- b. Please discuss the inefficiencies associated with lowering the price of the benchmark compared to the inefficiencies associated with discounts exceeding avoided costs.

### RESPONSE:

- a. The benchmarks, and the amounts they would need to be reduced by to be aligned with avoided costs, are shown below:

Discount	Benchmark	% Reduction in Benchmark
Automation AADC Letters	Automation Mixed AADC Letters	1.03%
Non-automation 5-digit Non-machinable Letters	Non-automation 3-digit Non-machinable Letters	3.25%
DNDC Carrier Route Letters	Origin Carrier Route Letters	4.17%
DSCF Carrier Route Letters	Origin Carrier Route Letters	6.94%
DNDC High Density/SaturationLetters	Origin High Density/Saturation Letters	5.80%
DSCF High Density/SaturationLetters	Origin High Density/Saturation Letters	9.66%

- b. Lowering the benchmark prices would reduce mailers' incentives to enter mail at the discount level rather than the benchmark level. Such actions could potentially reduce the number of mailers that presort at finer levels and/or dropship at the DNDC or DSCF. Put differently, lowering the benchmark prices would cause mailers to reevaluate whether the new

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discounts provided adequate incentives for them to presort their mailings themselves or to pay for transportation to bring their mail to certain processing facilities.

Notwithstanding the inefficiencies that may result from having passthroughs over 100 percent, pricing actions that have the potential to cause a substantial number of mailers to drop their mailings closer to origin facilities and/or enter less finely presorted mail would necessitate a reevaluation of how the Postal Service's processing assets are currently deployed. While the Postal Service has not specifically quantified the cost of reevaluating, and potentially redeploying, its processing assets, this risk alone warrants a measured and balanced approach (*i.e.*, not abruptly aligning the discount with avoided costs by adjusting the benchmark alone) to aligning the above passthroughs with avoided costs.

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9. The Postal Service justifies the following [Standard Mail] discounts pursuant to section 3622(e)(2)(B):

- Automation AADC Letters
- Nonautomation 5-Digit Nonmachinable Letters
- DNDC Carrier Route Letters
- DSCF Carrier Route Letters
- DNDC High Density and Saturation Letters
- DSCF High Density and Saturation Letters.

See FY 2016 ACR at 39-41; 46-49.

For each discount, please provide a plan to align the discount with its avoided costs. Each plan should include a schedule indicating when the full reduction will occur.

### RESPONSE:

The above discounts have the following passthrough percentages calculated at FY 2016 ACR cost avoidances and Docket No. R2017-1 prices:

Discount	Benchmark	FY 2016 ACR Pass-through	FY 2016 ACR Cost Avoidances w/R2017-1 Prices Passthrough
Automation AADC Letters	Automation Mixed AADC Letters	121.4%	121.4%
Non-automation 5-digit Non-machinable Letters	Non-automation 3-digit Non-machinable Letters	125.4%	122.5%
DNDC Carrier Route Letters	Origin Carrier Route Letters	160.0%	150.0%
DSCF Carrier Route Letters	Origin Carrier Route Letters	187.0%	165.2%
DNDC High Density/Saturation Letters	Origin High Density/Saturation Letters	160.0%	120.0%
DSCF High Density/Saturation Letters	Origin High Density/Saturation Letters	187.0%	134.8%

Contingent on price cap availability, operational efficiencies, and changes in cost avoidance, the Postal Service plans to reduce each of these passthroughs by a minimum of 10 percentage points (e.g., the Automation AADC Letters passthrough will be reduced from 121.4 percent to no higher than 111.4 percent) in each subsequent price adjustment until each passthrough reaches 100 percent or lower.

Under this schedule, and given the current passthrough levels using Docket No. R2017-1 prices, the Postal Service expects to reduce the Automation AADC Letters and

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Non-Automation 5-digit Non-Machinable Letters passthroughs to 100 percent after three general market-dominant price adjustments. The Postal Service expects to reduce the DNDC Carrier Route Letters passthrough to 100 percent after five general market-dominant price adjustments and the DSCF Carrier Route Letters passthrough to 100 percent after seven general market-dominant price adjustments. The Postal Service expects to reduce the DNDC High Density/Saturation Letters passthrough to 100 percent after two general market-dominant price adjustments, and the DSCF High Density/Saturation Letters passthrough to 100 percent after four general market-dominant price adjustments.

However, because a number of factors influence passthroughs, the Postal Service cannot predict with certainty when it will successfully align each of the discounts with its avoided costs. For instance, the relevant cost avoidances have largely fluctuated from year to year since the PAEA was enacted, as demonstrated in the table below.

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	<b>Cost Avoidances</b>			
	<b>Auto AADC</b>	<b>Non-Auto 5D</b>	<b>CRT/HD/SAT DNDC</b>	<b>CRT/HD/SAT DSCF</b>
	<b>Letters</b>	<b>Letters</b>	<b>Letters*</b>	<b>Letters*</b>
2007	0.013	0.083	0.186	0.225
2008	0.018	0.117	0.221	0.267
2009	0.017	0.115	0.186	0.236
2010	0.019	0.093	0.256	0.307
2011	0.019	0.074	0.317	0.377
2012	0.018	0.077	0.284	0.355
2013	0.020	0.069	0.315	0.395
2014	0.016	0.065	0.321	0.376
2015	0.015	0.072	0.016	0.020
2016	0.014	0.071	0.020	0.023
Source: ACR Workshare Discounts and Passthroughs				
* Changed from \$/pound to \$/piece in FY2015				

With no intent of undermining its foregoing position, for illustrative purposes only, the Postal Service provides the following schedule. Assuming that the Postal Service adjusts market-dominant prices annually for the next seven years and that the cost avoidances do not fluctuate as significantly as they have over the previous 10 years: 1) the Automation AADC Letters, Non-Automation 5-digit Non-Machinable Letters, and DNDC High Density/Saturation Letters passthroughs will reach 100 percent no later than 2019; 2) the DNDC Carrier Route Letters passthrough will reach 100 percent no later than 2022, 3) the DSCF Carrier Route Letters passthrough will reach 100 percent no later than 2024 and 4) DSCF High Density/Saturation Letters passthrough will reach 100 percent no later than 2021.